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New York Railways Company

Why a charge for transfers is justified on the line...

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WHY

A Charge for Transfers

IS JUSTIFIED

On the Lines of the New York Railways Company

308
Z
Box 55

ISSUED BY

NEW YORK RAILWAYS COMPANY

THEODORE P. SHONTS, President.

May 22, 1917

WHY

A Charge for Transfers

IS JUSTIFIED

On the Lines of the New York Railways Company

WHY A CHARGE FOR TRANSFERS IS JUSTIFIED

The statutory rate of fare upon street railroads in New York State is five cents. The average fare actually received by the New York Railways Company is less than three and one-half cents. The average fare has been falling for the last twenty to thirty years. This was the result of the increasing use of free transfers.

Those transfers were required by the legislature as a consideration for the privilege of permitting one street railroad company to lease and operate the lines of another. It was supposed by the legislature and by the companies when they were arranging for consolidation that so much new business would be developed and so many economies of operation would result that the free transfers would still leave a fair return upon the investment. For over ten years it has been evident to all acquainted with the constantly increasing costs of operation and the parallel decreasing revenues per passenger, that the supposition was a fallacy.

As it is the transfer passenger who has been the cause of the reduction in revenue, it is only fair that the transfer passenger should now pay a fair price for the transportation which he has been receiving free for many years. There were 257,028,563 passengers who paid a five cent fare last year.

About 92,000,000 of these used transfers, leaving about 165,000,000 who paid five cent fares and took no transfers.

Before increasing the fare charged to those who took no transfers, it would seem only fair to ask those who used two or three or more cars to pay for the privilege. If it could be assumed that all of these free transferees would pay for their transfers, two cents a transfer would produce $1,840,000, but as probably about one-half will not pay for a transfer, the increase in receipts will amount to only one-half that sum, or something over nine hundred thousand dollars.

I.

It is for the public interest that the transfers should continue and that the properties of the several companies should remain combined and be operated as a single railroad. But the interest must be paid upon the bonds, the rentals must be paid upon the leased lines, and the property must be kept up to a high state of efficiency to permit such continuance. It is only fair that the passengers who benefit from such conditions should be the ones to pay a fair price for the advantage.

As was said by the Public Service Commission in Massachusetts: "An impecunious street railway is a poor public servant; often it is an unsafe public servant. It is most desirable that these passenger carriers should have such income that they may furnish safe, convenient, adequate and com-

fortable transportation service to their patrons. Such service the public wants, and is willing to pay for, when convinced that it is paying only for what it gets."

By payment of two cents for a transfer the property can be kept together. It is better to pay seven cents for a ride upon two or more cars of a consolidated company than to have to pay ten cents for the same ride upon the cars of independent companies after the consolidation has been destroyed.

II.

Increased Cost of Rendering Public Service.

It needs no argument to demonstrate that the cost of labor and materials has been increasing at a greater rate than the present earning power of the property can stand. Wages have been increased from time to time to keep pace with the increased cost of living. Improvements in the equipment have been made notwithstanding the increased cost of materials. The property has not been skimped in maintenance. Taxation has each year taken in one form or another over a million and a half dollars on the average for the past five years, or over eleven per cent. of the gross revenue from railway operations. Greater tax burdens must be met in the immediate future. The war will still further increase the cost of materials and labor.

The property, in spite of all these burdens, has been efficiently managed, and the public has received adequate and satisfactory service except for a comparatively brief period when the effort of out-

side agitators to drive the employees into their organization disarranged the service. But that was overcome and for several months service has been normal, although the gross revenues have not yet reached their normal level.

With the opening of the new rapid transit lines in the immediate future, it is certain that there will be a great reduction in the gross passenger revenue. The experience of the past demonstrates this. How much the riding will be diverted is difficult to estimate. It might be enough to offset entirely the gain from a charge for transfers.

III.

Actual Return on Stocks and Bonds.

The aggregate amount of stocks and bonds of the New York Railways Company (including the underlying bonds of merged companies) and the stocks and bonds of the leased companies which are not in the treasury of the Railways Company in 1916 was $99,459,978. The entire amount of return received by the holders of these securities was $3,455,610.43, or 3.4%.

The average amount of such securities for the past five years was $97,925,454, upon which the average yearly return was $3,877,201.32, or 3.959%.

IV.

What a Utility Is Entitled To Earn.

From 1850 to 1910, a period of sixty years, the Railroad Law of New York provided that fares

would not be so reduced as to produce less than 10% upon the capital actually expended. The exact language was as follows:

> "The Legislature may when any such railroad shall be opened for use, from time to time alter or reduce the rate of freight, fare or other profits upon such road; but the same shall not, without the consent of the corporation, be so reducel as to produce with such profits less than ten per centum upon the capital actually expended; nor unless upon an examination of the amounts received and expended, to be made by the board of railroad commissioners they shall ascertain that the net income derived by the corporation from all sources for the year then last past, shall have exceeded an annual income of ten per centum upon the capital of the corporation actually expended."

The above was retained in the Consolidated Railroad Law reported to the Legislature of 1909 by the Board of Statutory Consolidation. The bill passed the Legislature but was not approved by the Governor (Hughes) because he had recommended the repeal of the 10% section because he believed that complete power as to rate should be vested in Public Service Commission.

In 1910 the Public Service Commissions Law was completely revised and amended. It was argued before the Legislature that the Commission should have power to raise as well as reduce rates and that if the ten per cent. provision were to be repealed there should be substituted a measure of

income which would prevent the Commission from impoverishing the railroads by improvident rates and which also would be a guide for action if it became necessary to increase rates to preserve the investment and maintain the railroad as an efficient public utility. This point was conceded and while the 10% limitation was removed from the Railroad Law in 1910, there was at the same time inserted into the Public Service Commissions Law, Section 49, a provision that as amended reads:

> "the Commission shall with due regard among other things to a reasonable average return upon the value of the property actually used in the public service and to the necessity of making reservation out of income for surplus and contingencies determine the just and reasonable rates, fares and charges to be thereafter observed and in force as the maximum to be charged * * * whenever the Commission shall be of opinion, after a hearing, that the maximum rates, fares or charges chargeable by any such common carrier, railroad or street railroad are insufficient to yield reasonable compensation for the service rendered and are unjust and unreasonable."

This provision of law prescribes four guides:

1. Reasonable Average Return upon
2. The value of the Property actually used in public service;
3. Necessity of reserving out of income for surplus, and
4. Contingencies.

Reasonable Average Return.

In the first place it must be noted that this phase looks toward the return to the owners of the property used in the public service of compensation. The return must be reasonable and it must *average* the lean and the fat years.

What return is reasonable? For sixty years, from 1850 to 1910, the People of the State of New York, through their representatives in the Legislature and in the Governor's chair, regarded 10% upon the capital actually expended as a reasonable return which they would not reduce. It was under this fair and businesslike rule that the millions were found to build up the railroads (both steam and electric) of the state. But ten per cent. was not the net return to the owners. Out of that they had to set aside reservations for surplus and contingencies. They had to lay something aside for strikes, panics, great fires, floods and the inevitable rainy days. The law since 1910 has recognized the necessity for surplus and contingencies in addition to return so that we may assume that something less than ten per cent. should be allowed as compensation for the use of the property by the public.

It can not be made less than six per cent. because to take property for public use for less than six per cent. is confiscation according to the Supreme Court of the United States in the Consolidated Gas case.

The entire nation through Congress and the President has recently recognized eight per cent.

as a reasonable return in the excess profits tax law.

The City of New York recognizes 8-76/100 per cent. as a proper return and contracts to receive that return upon its money invested in the new Interborough subways.

Six per cent. is the legal rate of interest in New York for loans upon real estate mortgages. Certainly money invested in the service of the public is entitled to greater compensation in view of the greater business risks, than one can get from a farm mortgage.

Before conditions became abnormal since the commencement of the war in 1914, no manufacturing or commercial business was considered profitable or successful which did not net to its owners a greater return than the legal rate of interest.

Since the European war began, the great nations of the world have paid over six per cent. in the United States for money secured by their inexhaustible credit.

Other arguments might be made but it seems as if it is clear that a return of say seven per cent. is a reasonable average return and that its reasonableness will be recognized by every fair minded man who gives the subject disinterested consideration.

Surplus.

If the return be fixed at seven per cent. as the average yearly compensation for the use of the property, it is apparent that to provide against the

lean years and maintain a uniform return, the Company ought to be allowed to set aside at least one-half of one per cent. for the creation of a reasonable surplus fund. The right to a surplus is recognized in the statute and the only question is as to its amount. That a proper reservation for surplus should be included in the return allowed in rate cases has been judicially established. A very clear exposition of this principle in an instance where there was no statutory provision for the allowance (as there is in New York) is contained in Judge Sanborne's decision in the *Minnesota* rate cases, 184 Fed. 765, 815, where he says that the owners of a railroad "owe the duty to the governments and to the public to operate their railroad continually in days when its operation is unprofitable as well as when it is remunerative, a duty they must discharge under the penalty of the forfeiture of their property if they fail. In view of these facts they ought to be permitted to receive a return large enough to enable them to accumulate in prosperous days a surplus sufficient to enable them to protect their property in days of disaster and to make their average return through days of prosperity and of adversity fair and just."

Contingencies.

Proper accounting will require the reservation from income of sums to take care of exhaustion of capital through depreciation, inadequacy and obsolescence. Such reserves are proper operating expenses and are not only allowed, but required by the Commission. In the case of the New York Railways Company, the Commission or-

dered that twenty per cent. of the gross revenues be set aside for maintenance and depreciation.

But there should be allowed (as provided by the statute) an additional sum for contingencies which go beyond the ordinary wear and tear. There may be great fires, floods, strikes, wars, domestic turbulence and riots, financial panics and similar extraordinary conditions which should be provided for to insure the public the uninterrupted use of the property and to secure its owners in their average return. In the situation here surely a reserve of one-half of one per cent. per annum would not be excessive. This when added to the same amount for surplus would amount to only one per cent. altogether.

The Courts have recognized the necessity of a provision for surplus and contingencies. But as the New York Statute expressly requires such necessity to be considered, it is hardly worth while to go into court decisions. In the *Arkansas* rate cases (187 Fed. 290) decided in 1911, the Court allowed one and one-half per cent. to provide for surplus and contingencies in addition to the rate of return of six per cent. determined to be fair for the owners of the property.

The reserve for surplus is to insure the owners of the property in the receipt of their returns. If the property continues to yield an average of seven per cent. per year, then the surplus, being the property of the owners, will ultimately be divided among them. But the reserve for contingencies will never reach the pockets of the owners because

undoubtedly it will be expended for one or all of the purposes mentioned or for other unforeseen losses.

The *return* then would be seven per cent., *surplus* and *contingencies* one per cent., or eight per cent. altogether.

This is two per cent. less than the ten per cent. allowed in this state for sixty years.

In 1906, the State Gas Commission found that eight per cent. was a reasonable return upon the actual value of property used in gas manufacture in Saratoga.

In 1911, the Public Service Commission in the New York City (1st) District determined that "a fair return on both gas and electric undertakings for the purposes of the present case would not exceed eight per cent. This rate would be equivalent (Commissioner Maltbie wrote) to a dividend of ten per cent. upon stock equal to one-half of the fair value, if bonds to the amount of one-half were financed upon a six per cent. basis; or eleven per cent. dividends if bonds were on a five per cent. basis." (2 P. S. C. Rep. 1st District p. 580.)

In the same year the same commission allowed seven and one-half per cent. to the Kings County Lighting Company. (2 P. S. C. Rep. 1st District, 659.)

In 1911 in Nebraska, a street railroad (Lincoln Traction Company) was allowed a return of eight per cent. upon the value of the property.

In 1916 the Public Service Commission, First District, allowed the Newtown Gas Company to maintain rates producing a return of seven per cent. (Pub. Util. Rep. Ann. 1916-D, p. 825.)

V.

What is the Value of the Property Actually Used in the Public Service?

It will be noted that the law from 1850 to 1910 allowed ten per cent. "upon the capital actually expended." At the hearings before the legislature it was contended by the representatives of the Public Service Commission that this phrase should be changed to get rid of any supposed "water" in the capital stock. Accordingly, the return must now be calculated upon the value of the property actually used in the public service.

Ordinarily, such value would have to be ascertained by a lengthy examination and appraisal. In the case of New York Railways Company all such work was done while the property was in the hands of the Receivers of the Metropolitan Street Railway Company. Both the Reorganization Committee and the Engineers of the Public Service Commission made careful appraisals of the property. The records in the Reorganization case contain the valuations. The lowest figure found by the Public Service Commission was as of October 1, 1910, $85,801,000.

From October 1, 1910, to December 31, 1911, the Receivers made additions and betterments

which increased the value of the property over $1,000,000. The value was therefore at least $86,801,000 when acquired by New York Railways on January 1, 1912. Since that time $2,265,000 of capital expenditures have been added by the Railways Company, bringing the value up to $89,066,000 as of April 1, 1917, starting with the appraisal of the Commission as of October 1, 1910.

The experts for the Reorganization Committee testified that the value was from $105,540,000 to $110,123,000, exclusive of any allowance for superseded property or going concern value or established business value.

It is not necessary, however, at this time to undertake to reconcile these estimates or to ascertain exactly the actual value for the purpose of demonstrating that the existing revenues must be increased to produce a reasonable return upon even the minimum value conceded by the Commission and brought up to date. In round numbers and for the purpose of this discussion it may be assumed that the value is $89,000,000.

Actual Return Versus Reasonable Return.

The property included in the valuation of $89,000,000 is actually used in the public service. For the purpose of this discussion, the several different railroads are regarded as a single railroad. The New York Railways Company may be regarded simply as the operator or General Manager, leaving out of consideration at this point all questions relating to that company's assets or lia-

bilities. The question then is, what does the *property* receive as an average return from its public use? For the last ten years the property was operated, for nearly the first five years by receivers, and since January 1, 1912, by the Railways Company. It would seem hardly worth while to go into receivership operations which are always abnormal. Starting, therefore, on January 1, 1912, it will be convenient to take the succeeding five years' experience as demonstrative of the average return.

The sources of income from the property under consideration were as follows:

1. Revenue from Transportation
2. Advertising
3. Rent of Equipment
4. Rent of Track and Terminals
5. Sale of Power
6. Miscellaneous Revenue
7. Miscellaneous Rent Revenue—Net Income from real estate
8. Interest Revenue from funds and balances
9. Profits from Operations of Local Cars on Williamsburgh Bridge
10. Forfeiture on defaulted contract for sale of land.

The deductions to be made from the foregoing sources of income to ascertain the net, are as follows:

1. Operating Expenses, including track and terminal privileges, hire of equipment, miscellaneous rent of land and buildings;

2. Taxes Assignable to Operations;
3. Loss on Operations on Manhattan Bridge.

NOTE:—There are no deductions made for rent for lease of other roads, interest on funded debt, or other interest obligations.

After the foregoing deuctions there is left the net earning power of the property as a return for its use. Dividends received upon stock of leased lines in the treasury of the Operating Company have not been included, because such stock is not included in the property going to make up the valuation of $89,000,000. While such dividends have been set forth in the annual reports and in the accounts, as a matter of fact, they only went to reduce the rentals for the use of the leased lines. The rentals were paid in full to the lessor companies as dividends, and then came back, in part, into the treasury. They have nothing to do with the earning power of the property. Such return, or earning power, for the five years ended December 31, 1916, averaged $3,766,741. If the property had earned eight per cent. on its value of $89,000,000, the return would have been $7,120,000.

The public got free service worth the difference of, say, $3,353,259 each year. This free service was at the expense of the owners of the property devoted to public use.

The trouble is that the gross revenue from passengers has not been equal to the value of the service rendered. The number of transfer passengers carried free has reduced the average fare for the five years to less than 3½ cents. This fare will not

produce enough revenue. It must be increased. There are two ways. Either raise the fare from five cents, or leave the fare at five cents and charge two cents for a transfer with the usual retransfer privilege now allowed.

It is estimated that a charge of two cents per transfer will increase the revenue approximately $900,000 per year.

This is calculated upon the assumption that a charge of two cents per transfer will reduce the number of transfer passengers fifty per cent. It may be more or less—experience alone will tell. A passenger going only a couple of blocks on an intersecting line will probably not pay the extra two cents—so also a passenger living within a couple of blocks of his main line will probably walk to that line instead of using two cars as at present. Assuming that one-half the present transfer passengers will pay the extra two cents, the increased revenue of about $900,000 added to the average gross income will produce $4,666,741. This is less than five and one-quarter per cent. upon $89,000,000, the lowest estimate of the value of the property. It would not be sufficient to provide for the accumulation of a proper fund for surplus and contingencies.

Actual Return on New York Railways Company Capital.

After the necessary appropriations have been made from existing revenues of the operator for the rentals assured to lessors by contract and for the

interest on first mortgage bonds, little has remained for the holders of the second mortgage income bonds of the New York Railways Company and its stockholders. The free service which the public has received has come out of their pockets.

The stockholders have never received a dividend, and the holders of the adjustment bonds have never received the full five per cent. interest in any calendar year. If the revenues from operation should be increased by the proposed charge for transfers, the situation would be bettered but not corrected.

The interest charges (excluding five per cent. on the income bonds) and net rentals, which have come out of gross income, amount to $2,941,069. Deduct this from the average gross income of $3,766,741, and there is left only $825,672 to apply toward the payment of the interest upon the five per cent. income bonds which amounts to $1,531,349 each year. If the increased transfer revenue (assumed to be $900,000) be added, the amount will be $1,725,672, or $194,323 over what is required to pay the interest upon the income bonds. This sum of $194,323 is a trifle over 1.1% upon the $17,500,000 capital stock of the New York Railways Company.

The reduced use of transfers will possibly reduce operating expenses somewhat, and the economies thereby effected will tend to increase the allowance, but it is impossible to say to what extent.

It must be noted that this does not mean that even this small amount will be available for dividends. Something must still come out for surplus

and contingencies. It may well be that the entire amount should be held in reserve, in which case it will not result in any benefit to the stockholders in the immediate future.

It is true that some of the stocks of the leased lines received dividends very much in excess of this average return, but it is also true that the income bonds did not receive their full five per cent. interest, and that the capital stock of the New York Railways Company received nothing at all.

It is quite immaterial how the return shall be distributed among the owners of the several classes of securities. The public does not care whether a large rental is paid for one line in the system and a small rental for another, or how the bond interest is distributed as between the different lienors, so long as in the aggregate the public is not asked to pay more than a reasonable return.

Certainly less than four per cent. is not a reasonable return upon nearly one hundred million dollars of securities representing the principal street surface railroad property in the City of New York.

But as the claim has sometimes been made that the leased lines receive excessive rentals, it will be interesting to see just what the average return has been on the leased lines. The stocks and bonds of the lessors in the hands of the public amounted to $21,999,946. The rental, in the shape of dividends and interest, paid to the owners of these securities was $1,655,629, or a return of 7.52%. As the average capitalization of the entire system in the hands of the public is $97,925,454, the portion thereof

represented by the stocks and bonds of the leased lines ($21,999,946) is 22.4%, which is the only part of the property which had anything like a fair return. And this was less than eight per cent.

The $21,999,946 of securities of the leased lines consist of $12,008,200 of bonds which received 4.97% and $9,989,746 of stocks which received 10.57%. The return on these stocks is only a trifle over the ten per cent. allowed by law in this state for sixty years. It cannot be reduced without the complete disintegration of the system through another reorganization. This would mean the return of the leased lines to their owners, with the right to charge a five cent fare upon each separate line.

In 1916, if the full five per cent. had been earned and paid upon the income bonds, $4,422,988.89 would have been disbursed, but this sum is only 4.4% on the total capitalization of $99,459,978.

If in the same year the bond interest had been paid in full and there had also been paid six per cent. on the New York Railways stock, the sum disbursed would have been $5,470,292.49, which is almost exactly five and one-half per cent. of the total capitalization in the hands of the public.

In fact the disbursement was 3.4% or $3,455,610.43, or $2,014,682.06 short of enough to pay bond interest in full and six per cent. on the stock without leaving anything over for surplus and contingencies.

From any point of view, we feel that a charge for transfers is justified.

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